

Washington State's
Experience Rating System

Foreword

During the 1984 Washington State Legislative Session, a bill was passed which significantly changed the way unemployment insurance (UI) was funded in this state. As a result, employers are taxed on the basis of their experience with unemployment.

Employer contributions to the Washington State Unemployment Insurance Fund are used to pay unemployment benefits to qualified claimants – benefits which sustain the purchasing power of the individual, the community and the state during periods of involuntary unemployment. Federal taxes finance the WorkSource placement system.

These Employment Security Department (ESD) programs are vital to the economic health of the community, the state and the nation. They affect businesses directly and indirectly. Employer payroll taxes therefore constitute an investment. To protect that investment, it is necessary to understand employer rights and responsibilities under the law, and to work with the Employment Security Department to ensure proper and efficient administration of these programs.

Furthermore, your employer tax rate will partially depend on your understanding of the system and your activities as an employer. The promptness and accuracy of reports and tax remittance will affect your tax rate, as will a cooperative effort to reduce unemployment.

This reduction is possible because there is more to experience rating than just individualized tax rates. Experience Rating is also employment stability. If we are able to provide greater employment opportunities in this state, the community of employers will benefit by lower taxes. If we are able to find work for those receiving unemployment insurance, the drain on the Unemployment Insurance Trust Fund will decline and lower employer taxes will result. If the Employment Security Department can place more unemployed workers through increased job listings with our WorkSource centers, lower employer taxes will result. If employers can reduce layoffs, lower taxes will result.

A team effort can be more effective in improving the state's unemployment insurance system than either the Department or employers working independently. This handout will provide some background information about how the Federal/State unemployment insurance partnership works and details of the Experience Rating legislation. Working together, we can shape the best possible unemployment insurance system for the state of Washington.

Origin of the Unemployment Insurance Program

The Unemployment Insurance Program is a federal/state system for providing partial compensation to workers who are temporarily and involuntarily unemployed. The original law, which was enacted by Congress in 1935 as part of the Social Security Act, encouraged states to enact conforming legislation by imposing a three percent tax on employers in all states. It stipulated that in those states with approved programs, employers would pay only ten percent of that tax to the federal government, and receive offset credit for the remaining 90 percent, because

of the taxes they paid under their state UI law. However, employers in states without approved programs would have to pay the entire three percent to the federal government. Within two years, every state had an approved unemployment insurance program.

That part of the Social Security Act was repealed in 1939 and reenacted as the Federal Unemployment Tax Act (FUTA).

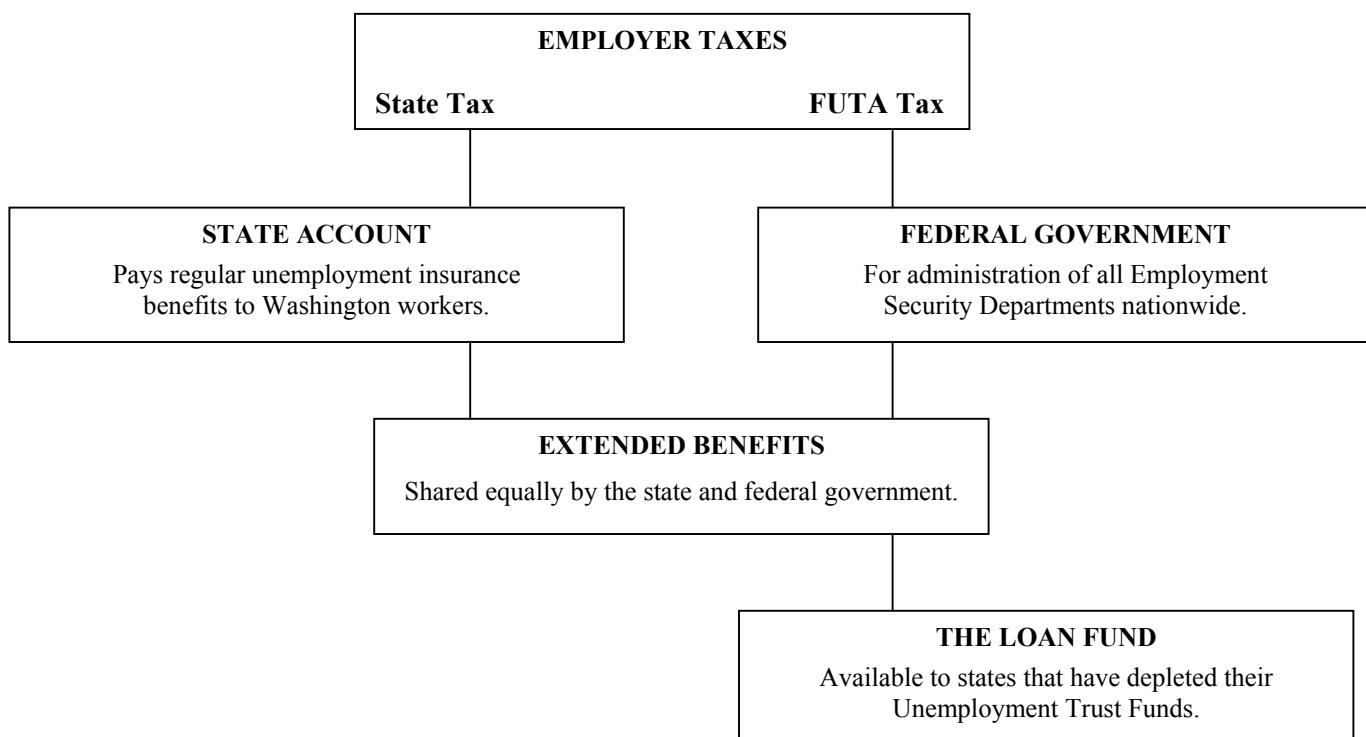
How the System Works

The state taxes are collected by the Employment Security Department and transferred to the state's account in the Federal Unemployment Trust Fund. Money is requisitioned as it is needed to pay State Regular Benefits and Washington State's share of Extended Benefits.

The Federal Tax is collected by the Internal Revenue Service (IRS) and transferred to the Federal Unemployment Trust Fund. The proceeds from this tax finance an Employment Security Administration Account to pay for administrative costs at the federal and state levels and to the Extended Unemployment Compensation Account to pay the federal half of Extended Benefits.

Excess from the Administration account, flows into the Extended Unemployment Compensation Account, and excesses from this account flow into the Federal Unemployment Account, which is commonly called the "loan fund". This account is used to advance funds to states that have depleted their State Trust Fund Accounts. No FUTA funds flow directly into the "loan fund". It catches the "spillover" from the Extended Unemployment Compensation Account.

Figure 1



Why Washington State's UI Tax Laws Were Changed

The 1984 Washington State Legislature changed the UI law to accomplish the following three objectives:

- ✓ **Trust Fund Solvency** – Under former UI financing provisions, Washington State's system had been seriously underfunded for many years. The trust fund went broke during 1984. At that time, it was necessary to borrow \$62 million from the Federal loan fund.
- ✓ **Federal Compliance** – Trust fund insolvency was not unique to Washington State. Consequently, in 1982, Congress enacted changes in the Federal FUTA system that mandated changes at the state level by January 1, 1985.

The FUTA tax rate was increased from the current 3.5 percent to 6.2 percent in 1985. The law leaves the Federal rate at 0.8 percent; and increases the offset credit to 5.4 percent, mandating a maximum tax rate of at least 5.4 percent on a wage base of at least \$7,000.

Congress also imposed an interest charge on most loans advanced after April 1, 1982, and stipulated that the interest must be paid from general revenues or from a separate fund raised by an additional tax on employers.

- ✓ **Experience Rating** – Under a variable, or experience rated system, employers are taxed in accordance with the degree to which their former employees draw unemployment insurance benefits. Employers with the most favorable experience are assigned the lowest rate, and those with the least favorable experience are assigned the highest rate.

Prior to the 1984 legislation, Washington was the only state without an effective variable rating system. Under the old law, Experience Rating "triggered in" only when the trust fund balance equaled or exceeded 4.1 percent of total wages, which last occurred in 1974, and was not expected to occur again.

Who Qualifies for Experience Rating

An employer can qualify to be in the computations for variable tax rates with two years' experience as a Washington employer.

To qualify for Experience Rating, an employer must have:

- Had some employment in Washington in at least one of the quarters indicated in Figure 2.

Figure 2

	January	April	July	October
2001				
2002				
2003				
2004				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter

- Had no period of four or more consecutive calendar quarters in the two years shown in Figure 3 for which no employment was reported.

Figure 3

	January	April	July	October
2001				
2002				
2003				
2004				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter

- Paid all contributions, interest, and penalties due for the two fiscal years indicated in Figure 4 by September 30 of the computation year.

Figure 4

	January	April	July	October
2001				
2002				
2003				
2004				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter

Important Notes

- ♦ Each year, the applicable periods move forward one year.
- ♦ The "computation date" is July 1; and the "cut-off date" for paying all contributions, interest and penalties is the following September 30.
- ♦ Employers who fail to pay contributions, interest and penalties by September 30 are assigned a penalty rate of 5.6%, unless they are in an appeal or have an agency approved Deferred Payment Contract (DPC).
- ♦ Employers who fail to meet the qualified employer requirements are assigned the average tax rate that has been assigned to qualified employers in similar industries plus 15 percent. The rate cannot be lower than one percent and cannot exceed 5.4 percent.

How Your Experience is Measured

Each qualified employer's experience with unemployment over the four fiscal years preceding the "computation date" is measured. For the 2005 tax rate assignment, this will be from July 2000 through June 30, 2004. Each qualified employer's benefit charges over the four-year base period will be divided by the employer's taxable payrolls for the same period to compute the benefit ratio. The calculations will be carried to six decimal places to reduce the probability of identical benefit ratios.

	January	April	July	October
2000				
2001				
2002				
2003				
2004				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter

How Tax Schedules Are Determined

Washington State's experience rating system has one tax schedule with 40 rate classes. Rate classes are determined by the employer's individual benefit ratio. The tax rates range from 0.0 to 5.4 percent. The tax schedule is as follows:

Benefit Ratio		Rate Class	Rate (Percent)
At Least	Less Than		
	0.000001	1	0.00
0.000001	0.001250	2	0.13
0.001250	0.002500	3	0.25
0.002500	0.003750	4	0.38
0.003750	0.005000	5	0.50
0.005000	0.006250	6	0.63
0.006250	0.007500	7	0.75
0.007500	0.008750	8	0.88
0.008750	0.010000	9	1.00
0.010000	0.011250	10	1.15
0.011250	0.012500	11	1.30
0.012500	0.013750	12	1.45
0.013750	0.015000	13	1.60
0.015000	0.016250	14	1.75
0.016250	0.017500	15	1.90
0.017500	0.018750	16	2.05
0.018750	0.020000	17	2.20
0.020000	0.021250	18	2.35
0.021250	0.022500	19	2.50
0.022500	0.023750	20	2.65
0.023750	0.025000	21	2.80
0.025000	0.026250	22	2.95
0.026250	0.027500	23	3.10
0.027500	0.028750	24	3.25
0.028750	0.030000	25	3.40
0.030000	0.031250	26	3.55
0.031250	0.032500	27	3.70
0.032500	0.033750	28	3.85
0.033750	0.035000	29	4.00
0.035000	0.036250	30	4.15
0.036250	0.037500	31	4.30

0.037500	0.040000	32	4.45
0.040000	0.042500	33	4.60
0.042500	0.045000	34	4.75
0.045000	0.047500	35	4.90
0.047500	0.050000	36	5.05
0.050000	0.052500	37	5.20
0.052500	0.055000	38	5.30
0.055000	0.057500	39	5.35
0.057500		40	5.40

The basic tax rates as determined by this schedule are then modified by a graduated social cost factor to pay for social costs in the system. First a flat social cost factor is determined by subtracting taxes paid by employers for the four consecutive quarters preceding the computation date from total unemployment benefits paid to claimants over those same quarters. This amount is then divided by total taxable payrolls and expressed as a percentage. This flat rate can be modified by trust fund solvency considerations. It can be reduced, for example, if the trust fund can finance more than ten months of recession benefits. The minimum flat social cost factor is 0.6 percent.

The graduated social cost factor is obtained by multiplying the flat social tax factor by percentages ranging from 78 to 120 percent, depending on the rate class of the employer:

- (A) Rate class 1 – 78 percent;
- (B) Rate class 2 – 82 percent;
- (C) Rate class 3 – 86 percent;
- (D) Rate class 4 – 90 percent;
- (E) Rate class 5 – 94 percent;
- (F) Rate class 6 – 98 percent;
- (G) Rate class 7 – 102 percent;
- (H) Rate class 8 – 106 percent;
- (I) Rate class 9 – 110 percent;
- (J) Rate class 10 – 114 percent;
- (K) Rate class 11 – 118 percent; and
- (L) Rate class 12 through 40 – 120 percent.

The employer's total tax rate is the sum of the employer's tax rate from the tax schedule and the graduated social cost factor, but cannot exceed 6.5 percent for most employers. For agricultural, fishing and certain food processing employers the limit is 6.0 percent.

The Tax Ceiling

The tax rate is then applied to the tax ceiling to determine the employer's tax liability. The tax ceiling is the maximum amount of an individual employee's wages subject to tax. The tax ceiling is determined annually as 80 percent of the average of the three preceding years' average annual wage rounded to the next lower \$100. Beginning with calendar year 2007, the tax ceiling will be calculated as 80 percent of the preceding year's average annual wage, rounded to the next lower \$100.

Noncharged Benefits

Some benefits are not charged to base year employers:

- Benefits paid to claimants later determined to be ineligible.
- Benefits paid for employment in Washington and another state, if the claimant could not have qualified for benefits based on Washington employment only.
- Benefits paid to claimants whose wage credits had been frozen while they were temporarily disabled.
- The state's share of Extended Benefit costs.
- Benefits paid because of a determination that no stoppage of work exists during a labor dispute.
- Benefits paid after a disqualification for a misconduct discharge or a voluntary quit from an employer will not be charged to that employer.
- A voluntary quit not attributable to the employer.
- Discharge for misconduct connected with the employment.

In these last two cases, non-charging must be requested by the employer, in writing, upon notification a claim has been filed.

- A catastrophic event that results in a closure or severe curtailment of the employer's business that resulted in a layoff of employees.
- Employers of part-time employees where the employee is separated from at least one employer. Employers are non-charged so they are not penalized for separations that they have no control over or that are detrimental to their business.
- Benefits paid which represent the difference between benefits computed under law changes in EHB 2255 and what benefits would have been paid under prior law. These benefits are paid from the Reed Act, and are not considered to be socialized.

Non-charging is intended for taxable employers only, as they are the only experience rated employers. Reimbursable or Local Governments are specifically excluded from this law.

The Experience Rating Unit reviews the requests for non-charging, grants or denies relief and responds to appeals regarding non-charging, as required.

NOTE: All charged employers receive a quarterly notice of benefits charged against their experience rating accounts.

Glossary of Terms

Average Annual Wage: Total wages paid in covered employment in Washington State divided by the average monthly employment for a given calendar year.

Average Weekly Wage (AWW): Average annual wage divided by 52.

Base Period: The period for measuring a qualified employer's past experience with unemployment; the four fiscal years preceding the computation date (July 1 of each year). For claimants, the base period is the base year.

Base Year: For claimants, the first four of the last five completed calendar quarters immediately prior to the filing of an initial claim for benefits; the wages paid during this period are the basis of computation for the maximum benefit amount and weekly benefit amount. Since July 1987, claimants who cannot otherwise establish a valid benefit year may seek to base a benefit year on work in the last four completed quarters.

Base Year Employer: Any covered employer who paid wages to a given claimant during the base year.

Benefit Charge: The amount debited to the Experience Rating Account of a base year employer for benefit payments to former employees. These amounts are prorated in the case of multiple base year employers.

Benefit Ratio: The calculation measuring the individual employer's experience with unemployment during the base period, consisting of the benefit charges divided by taxable payrolls, carried out to six decimal places.

Claimant: Any individual who files a claim for unemployment insurance.

Determination: An official decision by the Employment Security Department regarding the unemployment claim of an individual or the tax status of an employer.

Disqualification: State law specifies claimants are disqualified from benefits for a definite or indefinite period. These include voluntarily leaving employment without good cause; discharge for misconduct, felony, or gross misdemeanor; misrepresentation; refusal to work; participating in a labor dispute which results in work stoppage; and full-time attendance at school.

Employer: Any individual, partnership, corporation or other type of organization that employs one or more individuals.

Extended Benefits (EB): A special extension of unemployment insurance paid under recessionary conditions, with the cost divided equally between state and federal government.

Fiscal Year: The state fiscal year is July 1 through June 30.

Frozen Wage Credits: Under certain circumstances, state law allows for the creation of a special benefit year for individuals who were injured, allowing use of a base year prior to the injury. This effectively "freezes" those wage credits. Such benefits are not charged to base year employers.

Noncharged Benefits: Unemployment insurance benefits that are paid to claimants, but are not charged against a base year employer.

Offset Credit: A credit towards the Federal Unemployment Tax Act (FUTA) tax allowed to employers who pay a state unemployment tax.

Qualified Employer: An employer who is eligible for a reduced tax rate by virtue of fulfilling two requirements: employment during certain specified periods, and timely payment of taxes.

Regular Benefits: Benefits paid from the state trust fund to claimants who meet all eligibility requirements.

Requalification: A process by which a claimant may reestablish eligibility for unemployment insurance through reemployment following a determination of ineligibility and a period of disqualification.

Social Cost: The amount obtained by subtracting taxes paid by employers for the four consecutive calendar quarters preceding the computation date from the total unemployment benefits paid to claimants over those same quarters.

Stoppage of Work: Under the labor dispute provision, a substantial curtailment of the normal operation of an employer at a given location.

Taxable Payroll: The dollar value of all wages subject to the unemployment insurance tax.

Tax Ceiling: An upper limit on the amount of wages subject to tax, set by legislation. Currently, it is 80 percent of the average annual wage for the preceding three years, rounded to the next lower \$100.

Tax Rate: The percentage assigned yearly to each employer to be applied against taxable wages paid to each employee up to the tax ceiling.

Total Wages: The dollar value of all wages paid in employment covered by Washington's UI law.

UI Trust Fund: The fund from which benefit payments are made. This fund consists of only employer taxes and interest income.